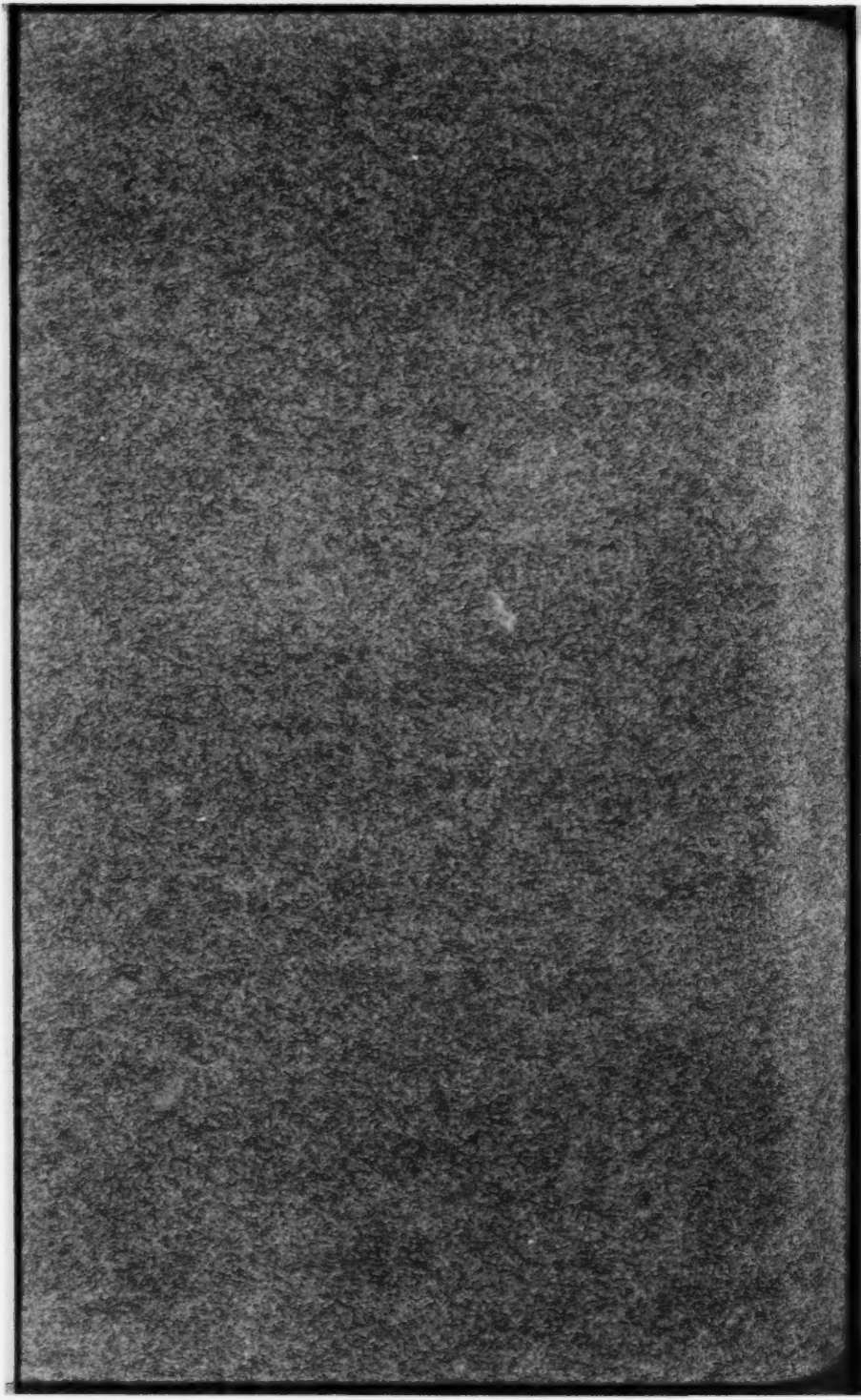

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and regulations involved	2
Statement	2
Argument	4
Conclusion	7
Appendix	8

CITATIONS

Cases:	
Carroll v. *Commissioner*, 70 F. (2d) 806	7
Craik v. *United States*, 31 F. Supp. 132	7
Helvering v. *Wilshire Oil Co.*, 308 U. S. 90	5
Jennings v. *Commissioner*, 110 F. (2d) 945	7
Neuberger v. *Commissioner*, 311 U. S. 83	6, 7
United States v. *Coulby*, 258 Fed. 27	7
Statutes:	
Revenue Act of 1934, c. 277, 48 Stat. 680:	
Sec. 23 (U. S. C., Title 26, Sec. 23)	8
Sec. 181 (U. S. C., Title 26, Sec. 181)	8
Sec. 182 (U. S. C., Title 26, Secs. 182, 188)	8
Sec. 183 (U. S. C., Title 26, Sec. 183)	8
Sec. 187 (U. S. C., Title 26, Sec. 187)	8
Sec. 801 (U. S. C., Title 26, Sec. 1696)	9
Miscellaneous:	
Treasury Regulations 86 (1934 Ed.), Art. 23(m)-16	9

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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 225

H. H. WEGENER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 25–34) is reported in 41 B. T. A. 857. The opinion of the Circuit Court of Appeals (R. 139–151) is reported in 119 F. (2d) 49.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 7, 1941 (R. 151). The petition for a writ of certiorari was filed on June 30, 1941. The jurisdiction of this Court is invoked under

Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer engaged in a business undertaking with two other individuals under an arrangement which constituted the venture a "partnership" within the definition of Section 801 (a) (3) of the Revenue Act of 1934. The question is whether the entire net proceeds received by the taxpayer in payment for services rendered to the "partnership" are taxable income, or whether one-third (the proportion of the taxpayer's interest in the undertaking) should be excluded.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 8–11.

STATEMENT

The pertinent facts, found by the Board of Tax Appeals and accepted by the Circuit Court of Appeals, may be summarized as follows:

In 1932 Walter H. Gant and Knox L. Garvin acquired an interest in certain oil and gas leases. They entered into an agreement with the taxpayer that he would take a one-third interest in the leases and drill wells on the property at an agreed price. Since the taxpayer expressed an unwillingness to enter into a partnership, no partnership agreement was signed. Gant and Garvin, however, assigned to him an undivided one-third of their interest, and

he assumed one-third of all their obligations in connection with its acquisition (R. 26–27).

The enterprise was conducted in the name of Gant, Garvin & Wegener (R. 27–28). The taxpayer undertook the drilling of the wells, and beginning with the latter part of 1932 charged Gant, Garvin & Wegener for the work at a specified price (R. 28). Payments were made from funds borrowed from banks (R. 28–29). These loans were secured by a deed of trust executed by the taxpayer and Gant and Garvin "as individuals and as partners" (R. 27–28).

Gant, Garvin & Wegener filed a partnership return on Form 1065 for the year 1935 (as well as for the prior years 1932, 1933, and 1934) showing gross profits of $174,609.15. No deduction was taken on the partnership returns for the expenses incurred in drilling oil wells, or for any amounts paid out for such drilling (R. 29).

The taxpayer, in his personal return for 1935, reported his *pro rata* share of the partnership income. During this year, however, he had also received $130,594.50 for drilling operations, which, after deducting expenses of $59,818.27, left a net profit of $70,776.23. He returned as income only two-thirds of the sum (i. e., the proportion corresponding to Gant's and Garvin's interests in the enterprise) (R. 29).

The Commissioner determined that the entire amount was taxable income. The court below

affirmed the decision of the Board of Tax Appeals sustaining this determination.

ARGUMENT

The question presented was correctly decided by the court below,[1] and is not in conflict with the decisions cited by the taxpayer.

1. Both the court below and the Board of Tax Appeals recognized that it was immaterial to the determination of the tax question whether Gant, Garvin & Wegener was a "joint venture," as the Board found, or a "mining partnership," as the taxpayer claims. The pertinent fact (which is not denied) is that Gant, Garvin & Wegener was a "partnership" within the definition of Section 801 (a) (3) of the Revenue Act of 1934, and was required to file a partnership return under Section 187 of the Act. Consequently, the taxpayer's taxable income would consist of his individual income

[1] The court rejected the Government's contention that the proceedings should be dismissed for want of jurisdiction. The contention rested on the grounds that no petition for review had been timely filed with the appropriate Circuit Court of Appeals under Section 1141 (b) (1) of the Internal Revenue Code, and that the stipulation, pursuant to Section 1141 (b) (2) of the Code, which designated the Circuit Court of Appeals for the Fifth Circuit as the court to review the Board's decision, had not been filed within the time allowed for filing a petition (R. 127–129). The Government, while entering into the stipulation, had reserved the rights to question its timeliness and legal effect and to question the court's jurisdiction (R. 126). The Government intends to raise these questions before this Court if the taxpayer's petition for certiorari should be granted.

and of his distributive share of the net income of the partnership computed, for purposes of the revenue laws, as the income of separate business entities. Revenue Act of 1934, Sections 182, 183, 187.

Consistently with the statute, therefore, the entire payment made by the "partnership" to the taxpayer for the drilling operations represented development costs to the former and income to the latter, as held by the court below. Nowhere in the statute is there a basis for contention that the payments should be treated as a *pro tanto* return of capital, or that the separate entities, for purposes of computing the tax liability, should otherwise be disregarded.

2. Appropriate adjustment for the circumstance that the proportion of the income received by the taxpayer corresponding to the proportion of his interest in the partnership represents in a sense his own funds is made in the computation of the partnership income. The "partnership" was entitled either to deduct the drilling payments made to the taxpayer as an ordinary expense or to capitalize those payments and recoup them through depletion. Sections 23 (m), 183, Regulations 86, Article 23 (m)–16. Cf. *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 95. Whichever option was taken the result would be reflected in the reduction of the partnership's net income and accordingly in the taxpayer's distributive share, thus offsetting the payments computed as individual income to the taxpayer.

Since in the instant case the payments had not been deducted as ordinary expense during the taxable year, the Board of Tax Appeals found that they had been capitalized (R. 33) and the court below agreed with this conclusion (R. 144). The result is that the proportion of the payments representing the taxpayer's interest will be returned to him by a reduction of the partnership's future net income through its depletion allowance. Regulations 86, Article 23 (m)–16 (b) (1). By the same token, none of the sums paid the taxpayer constitute a present distribution of partnership capital.

3. In *Neuberger* v. *Commissioner*, 311 U.S. 83, it was held that under Section 23 (r) (1) of the Revenue Act of 1932 a taxpayer could deduct from his share of partnership income derived from the sale of securities which were not capital assets, losses sustained on similar transactions. The basic question decided by the Court was that the distributed income retained in the hands of the individual partners the characteristics which it had when received by the partnership. The decision of the court below is not in conflict, since the instant case presents the substantially different problem of the taxability to a partner of funds which he has received for personal services performed for the benefit of the partnership.

4. The *Neuberger* case resolved a conflict between the lower court's decision in that case and

Jennings v. *Commissioner,* 110 F. (2d) 945 (C. C. A. 5th), and an asserted conflict with *Craik* v. *United States,* 31 F. Supp. 132 (C. Cls.). A similar question was presented in *United States* v. *Coulby,* 258 Fed. 27 (C. C. A. 6th). *Carroll* v. *Commissioner,* 70 F. (2d) 806 (C. C. A. 5th), also decided by the court below, involved the basis for depletion of partnership assets where the interests of the partners had been acquired at different times. It is evident that none of these cases relied on by the taxpayer establishes a conflict among the circuits, nor does a conflict otherwise appear.

CONCLUSION

The petition should be denied.

Respectfully submitted.

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JULY 1941.